BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001

POSTAL RATE AND FEE CHANGES, 1997	))))	Docket No. R97-1

MAJOR MAILERS ASSOCIATION'S INITIAL BRIEF

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Major Mailers Association (MMA) hereby presents its initial brief in opposition to the Postal Service's proposed rates for First-Class Mail.

OVERVIEW

The Postal Service's proposed increases in First-Class Mail rates cannot be justified on this record.

The Postal Service's case is premised on the notion that the Service will lose $2.4 billion dollars in the test year, Fiscal 1998 (USPS-T9, p. 47). In fact, however, the Service is likely to attain a 1998 profit of about one billion dollars[1]–its fourth consecutive billion-dollar profit.

Rightly concerned about this development, the Commission asked the Governors for an update, but it was rebuffed. Yet the Governors are misguided in believing that the Service is entitled to its requested rates solely in order to make unidentified new investments and to postpone future price increases. Such reasoning

[1] For the First Quarter of Fiscal 1998, the Postal Service's net operating surplus was $.98 billion, $.43 billion more that the Service's surplus during the First Quarter of 1997--a year when the Service's net operating surplus was $1.26 billion. Those figures tend to belie any suggestion the the Service's 1997 prosperity was a fluke, owing to the UPS strike.

could be advanced in favor of any level of current profits, no matter how excessive. Moreover, if a regulated entity sets current rates at excessive levels in the hope of benefiting future customers, it may be unlawfully discriminating against present customers.[2]

The Commission cannot blind itself to the Service's current prosperity. As the Commission has said, if it bases new rates on this stale record, its decision "may result in an outcome that does not sufficiently reflect actual events, thereby causing many mailers to pay inappropriate rates" (Feb. 24 letter to Governors). That is so since, even if the Governors defer the effective date of the new rates, those rates would still be "flawed" by their failure to reflect "representative, recent...fiscal and operating realities" (*Id.*)

As shown in this Initial Brief, there are also additional reasons to disapprove the proposed increases in First-Class rates. The Service's proposal is predicated upon a set of novel costing techniques that are inferior to the Commission's established methodology. (*See* Part I of this Brief.) Designed to perpetuate First-Class Mail's excessive burden of institutional costs, the Service's new costing techniques diminish objective standards for ratemaking (*See* Parts IB and C).

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[2] *Cf.* Re City of Sheridan, 17 PUR3d 496, 504 (Wy. PSC 1957) ("[T[he fiscal policy of creating a large surplus in the funds of the [regulated utility] through the proposed rates for unidentified projects is highly questionable", and "....the proposed method of making future improvements discriminates between present and future...users, as it will require present customers to pay higher rates for improvements they may never enjoy"); Re Maine Public Service Company, 12 PUR 3d 349, 351 (Me. PSC 1956) ("To permit or require that accelerated depreciation be a part of normal expenses would result in higher customer charges during the early years of service life and lower charges during the later years which would result in unjust discrimination against present customers").

There is no doubt about which mailers should benefit from the Service's current prosperity. Long-suffering First-Class mailers are entitled to rate relief in the form of a continued 32-cent stamp, if possible, and better discounts and lower additional-ounce-rates in any event. (*See* Part II.)

I. THE SERVICE'S NEWLY PROPOSED COSTING TECHNIQUES SHOULD NOT BE SUBSTITUTED IN PLACE OF ESTABLISHED METHODOLOGIES

To justified its proposed rates, the Service determined costs by means of novel methodologies. The Service wants the Commission to abandon established costing techniques in favor of the Service's new ones. The Service's case is not persuasive.

A. The Service Has Failed To Carry Its Heavy Burden of Proof To Support A Change In Costing Methodologies.

Where (as here) a regulated company seeks to uproot established commission precedent, it has a heavy burden of proof to support the proposed changes. See R97-1 Order No. 1197, p. 4 (citing 5 U.S.C. §556(d)); POR R94-1/38, p.2. *Cf. Providence Gas Co. v. Burke,* 419 A.2d 263, 268 (R.I. Sup. Ct 1980) ("The party seeking to change such a previously approved [depreciation] rate has the burden of persuasion on this issue"); *Central Maine Power Co. v. PUC*, 416 A.2d 1240, 1247 (Me. Sup. J. Ct. 1980) (utility proposing "a significant change in rate design" has burden of proof).

1. The Service's Case Is Weakened By Its Ragged Manner of Presentation

To satisfy its burden, the Postal Service should have presented its proof in a manner that was acceptable at least in form. In fact, however, the Service's testimony and exhibits are prolix, fragmented and confusing; they are marred by a profusion of errata sheets and supplemental filings. Moreover, the Service's witnesses based many of their conclusions upon nonrecord "library references" that the Service did not present on the record until finally ordered to do so at the end of the hearings on the Service's case-in-chief. Neither the Commission nor the parties should be required to accept radical changes in costing methodology on the basis of such a ragged presentation.

2. The Service's Costing Techniques Have Been Shown To Be Technically Deficient

Of all the Service's newly proposed costing techniques, the most misguided one is the Service's treatment of mail processing labor costs. The Service wants the Commission to discard its traditional rule that those labor costs vary 100 percent with mail volume. Criticizing the 100-percent-variable rule as a "simplistic and inaccurate assumption..." (USPS Trial Br., p. 21), the Service offers witness Bradley's study (USPS-T14) as a substitute.

But it is Dr. Bradley's study that is "inaccurate." As shown in more detail in Attachment A of this Initial Brief, the flaws in Dr. Bradley's study are many and fatal. First, the Bradley study is not a true measure of either cost or volumes. Instead, its econometric equations look at labor hours (which are not a proxy for costs) and piece handlings (which are not a proxy for volumes). Second, Dr. Bradley's data is suspect: he uses a type of data that the Postal Service itself has criticized as inaccurate; then he selectively discards enormous amounts of that data. Finally, Dr. Bradley's study scans only short-term costs, ignoring long-term ones.

3. The Errors In the Service's Methodology Yield Unreliable Estimates of Postal Costs

The errors in the Service's newly proposed methodologies produce very mistaken judgments about costs. A prime example is the Service's use of the Bradley study for estimating the unit processing and delivery costs for First-Class Automation letters. As compared with the Commission's costing methodology, the Service's methodology grossly underestimates these attributable costs, as shown in Table 1 (Tr. 21:11164):

Table 1. Comparison of Unit Attributable Costs For Processing and Delivery of First-Class Automation Letters (Cents)

First-Class Letters	Unit Costs (Proc + Del) USPS Method	Unit Costs (Proc + Del) PRC Method
Bulk Metered Benchmark	14.7	17.3
Automation Basic Presort	9.0	10.1
Automation 3-Digit Presort	8.2	9.1
Automation 5-Digit Presort	6.6	7.0
Carrier Route	6.4	6.4

For ratemaking, the consequence of this difference in methodologies is critical. As compared with the Commission's methodology, the Service's methodology understates the costs that are avoided when First-Class mailers presort and prebarcode their mail, as shown in Table 2 (Tr. 21:11165):

Table 2. Comparison of Unit Cost Savings For First-Class Automation Letters(Cents)

First Class Letters	Unit Cost Savings USPS Method	Unit Cost Savings PRC Method	USPS % Understatement of Cost Savings
Automation Basic Presort	5.7	7.2	- 20%
Automation 3-Digit Presort	6.5	8.2	- 21%
Automation 5-Digit Presort	8.1	10.3	- 21%
Carrier Route	8.3	10.9	- 24%

Because of its underestimate of the Service's savings from worksharing, the Service's methodology led the Service to propose *reduced* discounts. In fact, as explained in Part IIB of this Initial Brief, the Commission's methodology shows that worksharing discounts could be *increased*. When a methodology like the Service's leads to such misleading results, its reliability is questionable for any purpose.

B. The Service's Methodology Would Decrease Objective Cost-Based Ratemaking In Favor Of Subjective Demand-Oriented Judgments

There is no secret why the Postal Service prefers its newly proposed methodology. That methodology's appeal is its ability to shrink attributable costs, thus increasing the pot of institutional costs--costs which the Service can distribute by discretionary "pricing" judgments (Tr. 21:1161, 11163).

Ever since the first postal rate case--when the Service classified *fifty percent* of its costs as institutional (R71-1 Op., p. 41)--the Commission has been struggling to increase the percentage of costs that are classified as attributable. And rightly so. As Mr. Bentley noted (Tr. 21:11218):

> If all things are equal, it is better to attribute a pot of costs than not to. A separate but related goal of the Postal Service (and Commission) should be to to attribute as high a percentage of costs as reasonably possible. This makes the task of developing revenue targets [for each class] less reliant on subjective ratemaking criteria and reduces the risk of offering rates that are unduly discriminatory and result in cross subsidization. (*See also* Tr. 21:11219.)

Now the Postal Service is trying to reverse this process (Tr. 21:11163). If the Service succeeds, First-Class Mail will suffer. As the Commission knows, the Service has traditionally used its discretion over the "pot" of institutional costs to assign an excessive portion to First-Class Mail (Tr. 21:11163) .

In this proceeding, the Postal Service has been able to blunt the impact of its new methodology by asking for a far-below-normal rate increase. Yet, even in this proceeding, the Service's methodology would decrease attributable costs by \$5.1 *billion* (Order No. 1197, note 5) and increase institutional costs by a like amount (Tr. 21:11163, 11157). That has had no practical effect in this proceeding only because, in the midst of its current prosperity, the Service constrained the First-Class stamp increase to one cent (Tr. 21:11163). But if future cases are like recent ones, where the Service has asked for revenue increases two and three times the current request (*Id.*), the Service's change in methodology would be devastating for First-Class Mail.

C. The Service's Methodology Is Designed To Mask The Service's Failure To Relieve First-Class Mail Of An Excessive Share of the Service's Institutional Costs

The most serious fault of the Postal Service's methodology is this: it tends to hinder monitoring of the Service's continued overburdening of First-Class Mail.

1. The Commission's Prior Decisions Establish That First-Class Letters Are Being Burdened With An Excessive Share of The Service's Institutional Costs

Using its traditional methodology, the Commission has developed yardsticks quantifying the degree to which First-Class letters are being assigned an excessive share of institutional costs. In its past cases, the Commission has vowed to work towards reducing this burden. In Docket No. R87-1, the Commission articulated its "general goal" to set "First-Class cost coverage...close to system wide average," while third-class bulk mail (now Standard A Mail) should move towards a cost coverage "near average" (R87-1 Op., pp. 367, 380). In Docket No. R90-1, the Commission expressed displeasure about perpetuating a "situation in which First-Class mailers are providing revenues which more properly should be provided by third-class mailers...." (R90-1 Op., p. IV 33, n. 16). In Docket No. R94-1, the Commission rejected a proposed settlement that "would only amplify the distortions" in the two mail types' contribution to institutional costs (R94-1 Op., p. IV 16). Finally, in Docket No. MC95-1, the Commission reaffirmed its "view that the largest volume subclasses in First-Class and Standard Mail should have roughly equivalent markup indices" (Docket No. MC95-1, pp. I-8).

Nonetheless, the Commision has been forced historically to perpetuate First-Class Mail's high institutional cost burden, but only out of "serious concern" to avoid rate shock of other mailers (*See* R94-1 Op., p. IV 16). With considerable distaste, the Commission has accepted the resulting compromises. (*See* Tr. 21:11220-221, 11260-61, 11272-73.)

2. If the Commission Abandons Its Traditional Methodology, It Will Be Less Able To Measure Progress Towards Achieving Its Goal of Reducing First-Class Mail's Excessive Burden

If the Commission retains its established methodology, its traditional yardsticks will continue to give a valid comparison of the Service's proposed assignments of institutional costs from case to case. In contrast, "the Service's new methodology would obscure use of the Commission's yardsticks to measure how the Service's current proposal compares with past cases--resulting in a comparison of apples to oranges" (Tr. 21:11160). As MMA witness Bentley put it:

> [T]he Postal Service's cost methodology tends to "mask" the Service's failure to abide by the Commission's longstanding objective regarding the pricing of First-Class and Commercial Standard A Mail....The Postal Service's new methodology makes it inappropriate to compare markup indices, at the Service's proposed rates, to markup indices that result from previous Commission recommendations (Tr. 21:11209).

And

> The Postal Service's methodology makes the comparison with previous years unreasonable, and that's why it's being masked....[T]he Postal Service's methodology masks the relationships so that...you could not reasonably determine what was happening with the Postal Service's proposed rates compared with the R-94 results because the two numbers were no longer comparable....[I]n order to determine whether, in fact, they're [markup indices for First-Class Mail and Commercial Standard A mail] getting closer [to "roughly equivalent"], we have to maintain comparable numbers from case to case.... (Tr. 21:11306-08).

Recognizing this problem, Postal Service witness O'Hara wants the Commission to discontinue its traditional markup index yardstick in favor of a cost coverage index. (*See* Bentley, Tr. 21:11160, citing USPS-T30, p. 19.)

3. If the Commission Retains Its Traditional Methodology, It Will Find That the Service's Current Proposal Fails To Rectify First-Class Mail's Excessive Burden of Institutional Costs

By retaining its own established methodology, the Commission will find that the Service's proposed rates fail to provide First-Class Mail and Commercial Standard A mail with (as the Commission stated its goal in Docket No. MC95-1) "roughly equivalent markup indices."

Table 3. Measurements of Coverage, Markups, and Markup Indices For USPS Proposed Rates in Docket No. R97-1 Under PRC Costs [3]

	Coverages	Markups	Markup Indices
First-Cl. Letter	166%	66	119
Comm. Std. A	158%	58	106

Source: Tr. 21:11185

The Commission recognizes that coverage yardsticks "are not the only guide to the allocation of institutional costs....At the same time [it] is reviewing coverage levels [the Commission] review[s] the unit contribution and the total dollar contribution likely to be made by each subclass to see whether an inequity or inappropriate relationship may result" (R87-1 Op., p. 394). This unit contribution yardstick shows that the Postal Service's currently-proposed rates will continue to burden First-Class mailers with institutional cost contributions that are twice the contribution made by Commercial Standard A mailers. (See Figure 1 and Tr. 21:11162):

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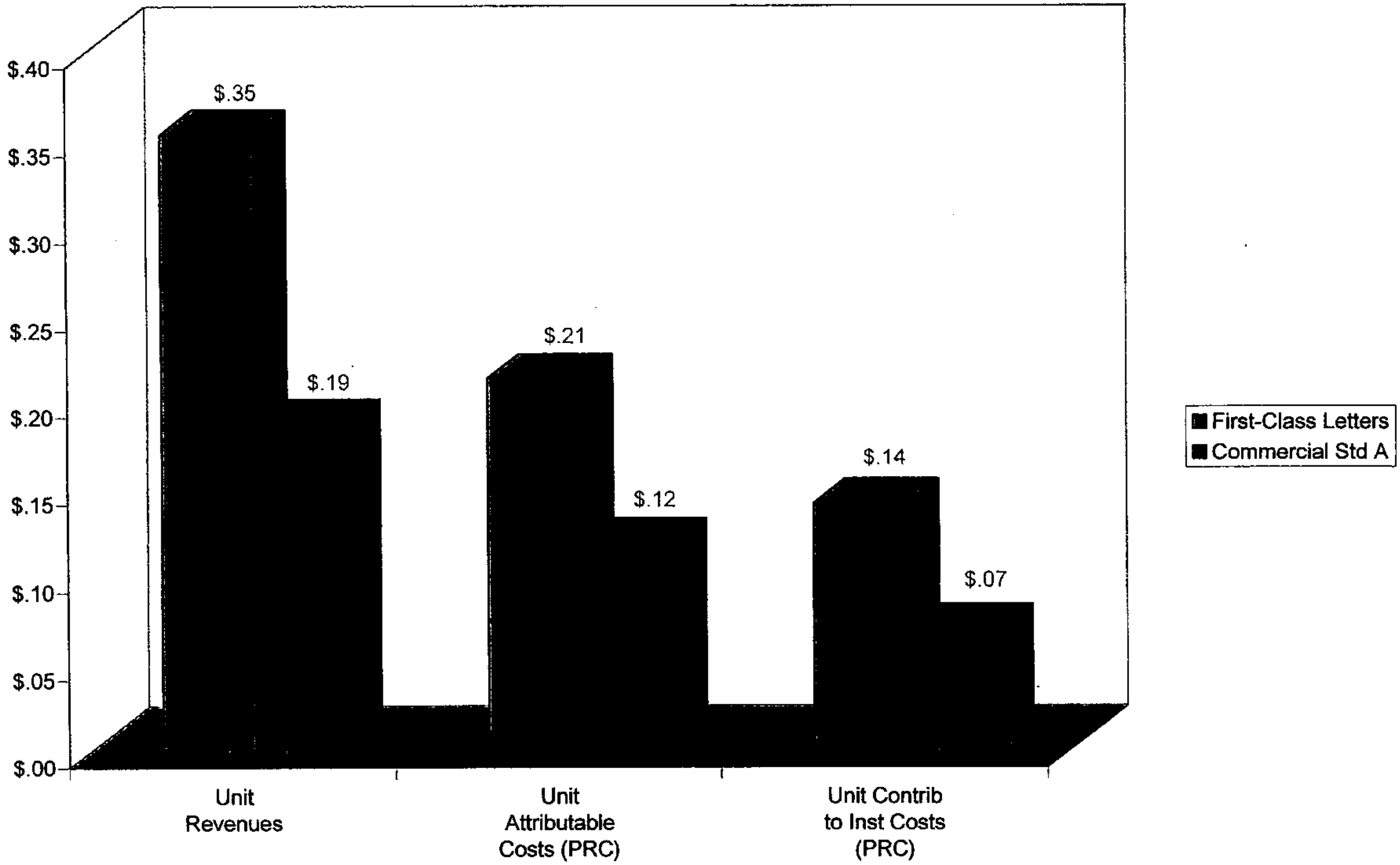
[3] Even using the Service's proposed cost methodology, the same conclusion can be drawn. The "coverage indices" for First-Class Letters and Standard Mail Commercial are 112 and 98, respectively. The markup indices are 128 and 95 respectively. See Tr. 21:11160, n.6.

Figure 1: Comparison of First-Class and Commercial Standard A Unit Revenues, Costs and Contributions to Institutional Costs Using PRC Cost Methodology (Docket No. R97-1, TY AR)



Copies filed with the Commission are in color.

Table 4. Comparison of TY AR Unit Contributions To Institutional Costs For First-Class & Standard Mail (Cents)

	Dkt. R97-1 Proposed	Dkt. R94-1	Dkt. R90-1
First-Cl. Letters	14.0	15.7	13.3
Comm. Std. A	6.9	6.0	4.5

Source: Tr. 21:11161

The comparison of unit contributions is especially telling since both types of mail are processed similarly, and both cost about the same (Tr. 21:11161). And the comparison to total dollar contributions is as disproportionate as the unit contributions (21:11184-85).

By adhering to its established methodology, the Commission will emphasize its commitment to pushing the Service towards lessening First-Class Mail's excessive burden of postal costs.

II. THE SERVICE'S PROPOSED RATES FOR FIRST-CLASS MAIL SHOULD BE REDUCED

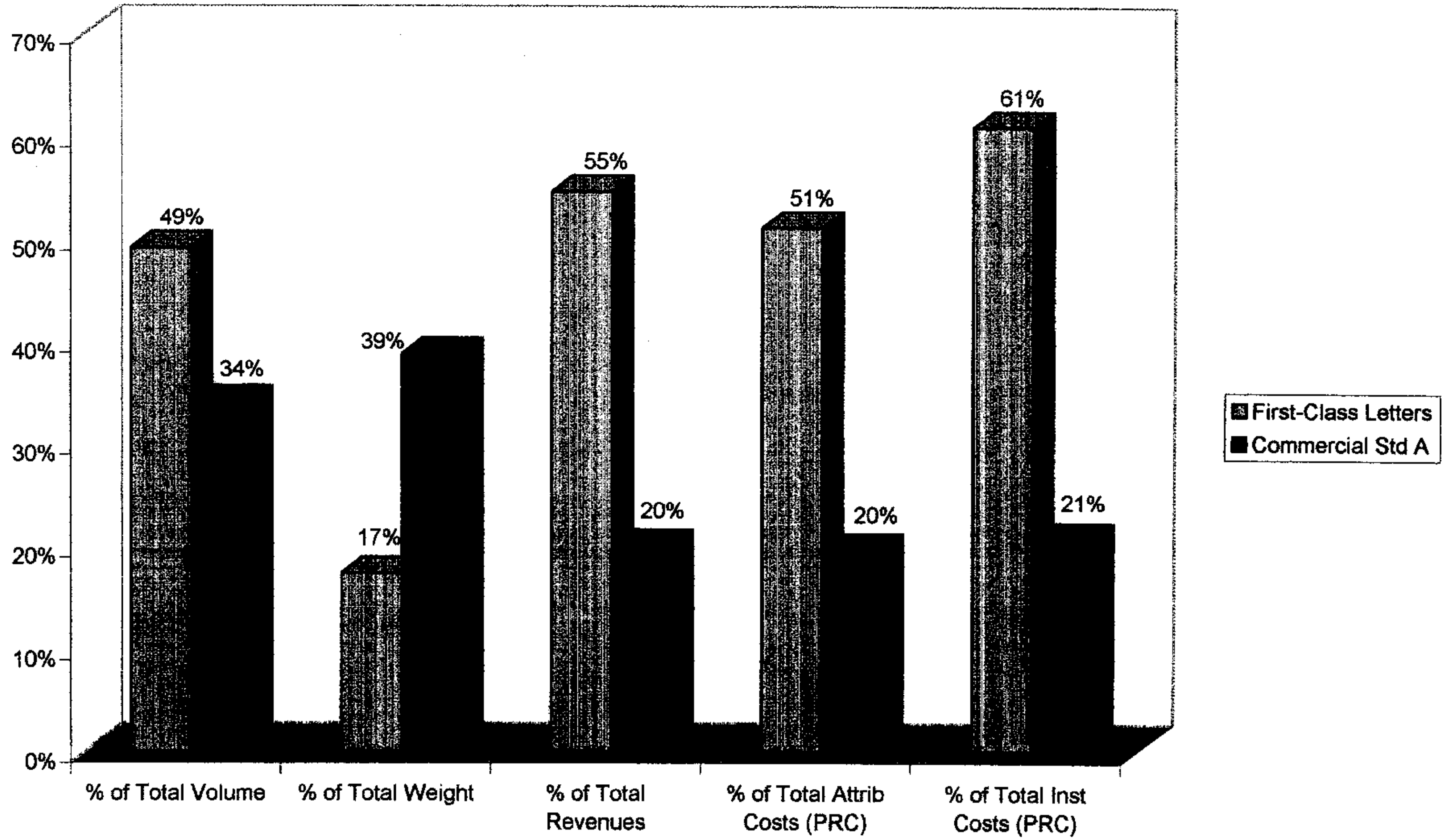
A. First-Class Mailers Are Entitled To First Priority For Rate Relief And, If Possible, Retention Of the Current 32-Cent Stamp

First-Class mailers' right to rate relief cannot be disputed. As just shown (Part IC1), the Commission has recognized repeatedly that First-Class Mail has been forced to make an excessive contribution to institutional costs. And the Service's current proposal would only continue that situation (Part IC3).

The result is that First-Class Mail also underwrites a disproportionate share of *total* postal costs. First-Class letters, which account for 49 percent of mail volume and only 17 percent of weight, are being asked to contribute 55 percent of total mail revenues (See Figure 2 and Tr. 21:11159, 11187). In contrast, Commercial Standard A mail, which

(Revised 2/11/98)

Figure 2: Comparison of First-Class and Commercial Standard A Using PRC Cost Methodology (Docket No. R97-1, TY AR)



Copies filed with the Commission are in color.

accounts for 34 percent of volume and 39 percent of weight, is being asked to provide only 20 percent of total mail revenues (*Id.*).[4]

As a first preference, the Commission should consider retaining the 32-cent First-Class stamp rate. In past cases, the Commission has had to compromise First-Class rate relief in order to avoid rate shock to other types of mail (*See* R94-1 Op., p. IV 16). In this proceeding, however, that concern is mitigated by the Postal Service's profitability. If the Commission takes account of the Service's record earnings, it may be able to save the 32-cent First-Class stamp by reducing the Service's revenue requirement, with or without minor increases in the proposed rates for other types of mail. (*See* MMA's Response to Notice of Inquiry No. 5.)

By retaining the 32-cent stamp without contributions from other mail types, the Commission could move much closer to its goal of "roughly equivalent markup indices" for First-Class Mail (116) and Standard A mail (110). (Tr. 21:11166.)

B. The Service's Proposed Reductions In First-Class Automation Discounts Are Erroneous

In proposing to *decrease* the discounts for First-Class Automation letters, the Postal Service erred in two respects. First, the Service's computation of unit processing and delivery costs is not based upon the Commission's traditional methodology; it is predicated upon the defective Bradley study. (*See* Part IA2 of this Brief.) Second, the Service failed to take account of post-Reclassification Case changes that reduce postal costs.

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[4] Standard A mailers often try to justify these discrepancies by adverting to differences in the processing of Standard A mail and First-Class Mail. But, although some differences in processing do exist, any differences in costs between the two mail types are already reflected in *attributable* costs (Tr. 21:11158).

These errors led the Service to propose decreasing Automation discounts by 0.1 cents to 0.6 cents (Tr. 21:11167):

Table 5. Comparison of Current and USPS Proposed First-Class Automation Discounts (Cents)

Rate Category	Current Rate	Current Discount	USPS Proposed Rate	USPS Proposed Discount
First Class:				
Bulk Metered Benchmark	32.0		33.0	
Basic Automation	26.1	5.9	27.5	5.5
3-Digit Automation	25.4	6.6	26.5	6.5
5-Digit Automation	23.8	8.2	24.9	8.1
Carrier Route	23.0	9.0	24.6	8.4

Combined with the one-cent increase in the basic stamp rate (from which Automation rates are computed), the Service's proposal results in a 3.8 percent overall rate increase for First-Class letters and a 4.6 percent increase for Automation letters (Tr. 21:11167).

1. The Reliable Cost Data Justify Discounts Higher That Those Proposed By The Service

The only support for the Service's proposed rates is the faulty Bradley study. Compared with the Commission's established methodology, the Service's use of the Bradley study understates the costs that are avoided when First-Class mailers presort and prebarcode their mail, as shown in Table 5 (Tr. 21:11165):.

Table 5. Comparison of Unit Cost Savings For First-Class Automation Letters(Cents)

First Class Letters	Unit Cost Savings USPS Method	Unit Cost Savings PRC Method	USPS % Understatement of Cost Savings
Automation Basic Presort	5.7	7.2	- 20%
Automation 3-Digit Presort	6.5	8.2	- 21%
Automation 5-Digit Presort	8.1	10.3	- 21%
Carrier Route	8.3	10.9	- 24%

To align Automation discounts with cost savings computed according to the Commission's methodology, MMA proposes that the Commission recommend discounts that are at least 0.2 cents higher than those proposed by the Service, as shown in Table 6 (Tr. 21:11168). (In some cases, MMA's proposed discounts are lower than the currently-existing discounts.)[5]

Table 6. Comparison of First-Class Automation Discounts (Cents)

Rate Category	Current Discount	USPS Proposed Discount	MMA Proposed Discount
First Class:			
Basic Automation	5.9	5.5	5.7
3-Digit Automation	6.6	6.5	6.7
5-Digit Automation	8.2	8.1	8.3
Carrier Route	9.0	8.4	8.6

MMA's proposed discounts will produce the First-Class Automation rates shown in Table 7 (Tr. 21:11169):

[5] MMA's proposed discounts result in an 81 percent passthrough of cost savings derived in this proceeding under the Commission's methodology. In contrast, in Docket No. MC95-1, the Commission's recommended discounts (which are now in effect) represented an average pass through of 97 percent. Based on the cost savings derived in this proceeding under the Commission's methodology, the currently-effective discounts represent an 81 percent passthrough (Tr. 21:1168-69).

Table 7. Comparison of Current, USPS Proposed and MMA Recommended First-Class Automation Rates (Cents)

First-Class Letters	Current Rates	USPS Proposed Rates	MMA Recommended Rates
Basic Automation	26.1	27.5	27.3
3-Digit Automation	25.4	26.5	26.3
5-Digit Automation	23.8	24.9	24.7
Carrier Route	23.0	24.6	24.4

If the Commission recommends adoption of MMA's proposed Automation rates, the Postal Service's proposed revenues will be reduced by about $72 million (Tr. 21:11169).

2. MMA's Proposed Discounts Are Conservative: They Do Not Take Account of Other, Significant Cost Savings That Followed Reclassification

As the Commission advised the Governors, the present record "reflect[s] pre-reclassification operating results," and the Service's cost characteristics "have undergone significant change" since reclassification (Feb. 24 letter). To be conservative, MMA witness Bentley used the Postal Service's own estimate of cost saving, changed *only* to substitute the Commission's costing methodology in place of the Bradley technique (Tr. 21:11223, 11236). Consequently, MMA's estimate of cost savings (like the Postal Service's) understates those cost savings because it does not take account of the additional, post-Reclassification savings attributable to move updates and mail preparation reforms, as well as the provision of qualified pre-barcoded reply envelopes (Tr. 21:1171-73, 11234).

If MMA witness Bentley had taken account of the savings from move updates and mail preparation reforms, he would have increased his estimate of unit cost savings attributed to First-Class Automation letters by an additional penny (Tr. 21:11225-26, 11237). In addition, by providing their customers with pre-addressed and barcoded reply envelopes, Automation mailers have reduced the Service's costs enough to offset the higher costs of handwritten single-piece letters (Tr. 21:11172, 11226). Those additional savings justify discounts that are even larger than MMA proposes.

3. MMA's Proposed Discounts Are Justified Even Under the Service's New Methodology

As just noted, the rate proposals of both MMA witness Bentley and Postal Service witness Bradley did not take account of the post-Reclassification reforms that created additional cost savings for Automation letters. ABE/EEI/NAPM witness Clifton estimates that the move update reform created additional unit cost savings of 0.262 cents (Tr. 21:11225-26). The Postal Service estimates that the MOD cost pool 1CancMPP (which represents culling, facing and cancellation) accounts for additional cost savings of 0.683 cents (Tr. 21:11226). Together, these two corrections would increase First-Class Automated letters' unit cost savings--even as computed under the Postal Service's own methodology--by almost a full cent (*Id.*).

Every one of MMA's recommended increases in the Service's proposed discounts is less than one cent. (*See* Table 6.) Consequently, MMA's recommended discounts are justified even under the Service's methodology.

C. The Surcharge For First-Class Letters Weighing Between 1.1 Ounce and 2.0 Ounces Is Unrelated To Cost And Should Be Reduced

1. The Additional-Ounce Rate Requires All First-Class Mailers To Pay Postage Rates That, As the Commission Recognizes, "Deviate..From the Actual Cost Pattern"

First-Class mailers must pay a surcharge whenever they send a letter weighing more than one ounce. Under current rates, a First-Class mailer pays 55 cents postage for a letter weighing 1.01 ounce; the mailer pays postage of 78 cents for a letter weighing 2.1 ounce. In the last rate case, the Commission denied the Service's request to increase this surcharge because "any increase in the extra ounce rate would cause prices *to deviate more than at present* from the actual cost pattern." (R94-1 Op., p. V-9. Italics supplied.)

It is time to begin moving the additional-ounce rate closer to "the actual cost pattern." As a conservative first step, MMA recommends reducing the additional-ounce rate for letters weighing between 1.1 ounce and 2.0 ounces. A one-penny reduction in that rate would reduce postal revenues by only about $26 million (Tr. 21:11173).

2. The Commission Has Recognized That Two-Ounce Letters Are Processed At The Same Cost As One-Ounce Letters

For many years, the Commission has recognized that the current additional-ounce rates are not justified by costs. In Docket No. R87-1, for example, the Commission noted that "[l]etters up to two ounces for the most part can be processed on the new automation at a cost no higher than a one ounce letter..." (R87-1 Op., p. 448).

The Commission was even more emphatic in the last rate case. There the

Commission observed: "Since Docket No. R90-1, information has become available indicating letters processed with automation incur minimal or possibly no extra cost for letters weighing up to three ounces" (94-1 Op., p. V-9).

3. The Postal Service's Own Reports Show That Additional-Ounce Rates Exceed Costs

In its reports, the Postal Service itself documented that the additional-ounce rate exceeds costs by a wide margin, at least for letters weighing up to two ounces. The Postal Service's Competition Services Task Force found that the "incremental ounce cost [*i.e.*, rate] for First-Class mail is extremely high compared to the incremental increase in the cost of handling" (Tr. 4:1444). Indeed, the Service's Three-In-One Study reported that, for 1992, the additional-ounce rates produced the following markups[6] over attributable costs (Tr. 4:1446):

OUNCE INTERVAL CURRENT MARKUPS: LETTERS

0-1 oz.	37%
1-2 oz.	125%
2-3 oz.	199%

Not surprisingly, the Three-In-One Study recommended eliminating the additional-ounce rate for First-Class letters under three ounces (Tr. 4:1444).

The Three-In-One-Study is consistent with our knowledge of the capabilities of the Postal Service's processing equipment. Postal Service witnesses have repeatedly testified that automation machinery can efficiently process letter-sized mail weighing up to two and one-half ounces or three ounces (Tr. 4:1440). Indeed, in Docket No. R90-1, the Service

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6 Markup, as the Service used that term here, is the cost coverage minus 100.

submitted a study (USPS LR-F-177) which MMA/ABA's witness interpreted as showing that one-ounce and two-ounce presorted letters' attributable costs are (Tr. 4:1442):

ATTRIBUTABLE COSTS FOR PRESORT MAIL
Test Year 1989

Ounce Categories	Average Weight (ounces)	Attributable Cost/Piece ($)
0.1-1	0.50	0.095
1-2	1.50	0.118

Plainly, the current additional-ounce rates--which charge a two-ounce letter nearly twice the rate for a one-ounce letter--are out of line.

6. The Service's Own Rates For Standard A Mail Prove That the Service Believes That There Is No Added Cost For Processing Two- And Three-Ounce Letters

The Service's own rate structure shows that letters up to three ounces are processed without additional cost. Thus, the Service has always designed third-class bulk (and now Standard Mail A) rates that do not change as weight increases from .1 to over 3 ounces. To illustrate, Standard Mail A Automation rates are the same for a letter weighing .6 ounces as for a letter weighing 2.9 ounces. Such a rate structure implies that weight has no bearing on the costs to process bulk letters and sends such a signal to mailers.

The result is unjustly discriminatory towards First-Class mailers, as shown in Table 8:

Table 8. Comparison of Proposed Rates For Five Digit Automation Letters Weighing 0.1 Ounce To 3.0 Ounces: First-Class Compared with Standard A Class

Unit Weight	First-Class Automation Postage (¢)	Standard Automation Postage (¢)[7]
0.1 oz. to 1.0 oz.	24.9	16.0
1.1 oz. to 2.0 oz.	47.9	16.0
2.1 oz. to 3.0 oz.	70.9	16.0

Source: Tr. 4:1435; Tr. 6:2764

Recently, the Service increased the weight limits for letters qualifying for Automation rates (Tr. 21:11174). After a year of "live" testing, the Service increased the maximum weights for both Standard A mail and First-Class mail to more than three ounces (Tr. 19-B:8761-64, 8802-03). This, too, recognizes that letters weighing up to three-plus ounces are processed on automated machinery without extra cost.

5. It Would Be Futile For the Commission To Delay Reform In the Hopes Of Obtaining More Data

In Docket No, MC95-1, the Commission was reluctant to begin reducing the additional-ounce rate because "there is still no definitive evidence of the costs associated with additional ounces...., a deficiency the Commission encourages the Postal Service and other parties to address in future proceedings" (Op., p. V-51).

But there never will be any more "definitive evidence." Only the Postal Service can update the already-ample evidence that is in this record, and the Service will continue to refuse to do so

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[7] No entry discount.

For more than a decade, the Postal Service has evaded the Commission's persistent requests for information about the actual cost of First-Class additional-ounce mail. After the Commission first established a degressive rate more than two decades ago (R74-1 Op., p. 195), the Commission repeatedly sought information that would allow it to achieve its "ultimate goal[, which] is to set the degressive rate at a level to reflect cost incurrence..." (R87-1 Op., p. 439). Thus, in Docket No. R84-1, the Commission told the Postal Service about this agency's "desire for data on the handling costs of additional ounces in future proceedings" (See *Id.*). Actually, having become impatient with the Postal Service, the Commission issued "a *directive* to the Postal Service that the provision of definitive empirical information on the effect of additional ounces on costs remains a desirable goal...." (*Id.* at 443. Italics supplied.)

But the Postal Service continued to defy the Commission's directive. In the last rate case, the Commission observed: "As in previous cases, the Postal Service has not provided reliable evidence on the handling cost of additional ounces" (R94-1 Op., pp. V-8 to V-9). By that time, however, the Commission had apparently decided that it was time for decisive action. The Commission reaffirmed that "The Commission's ultimate goal is to set a degressive rate which reflects cost incurrence" (*Id.* at V-9). Refusing to go along with the Service's proposed increase in the additional-ounce rate, the Commission froze that rate at the current 23-cent level (*Id.* at V-8).

The Postal Service continues to stonewall. In both the Classification Case and this proceeding, the Postal Service presented only bland statements that it proposed to retain the current additional-ounce rates, without offering any cost evidence whatsoever. Although in both proceedings MMA presented evidence showing that those rates greatly exceed costs, the Postal Service filed no rebuttal testimony on this subject.

There can be only one reason for the Service's unwillingness to come forward with data. The Service knows that any data will confirm that--as documented by the Service's studies discussed in Part IIC3 of this Brief--there is no extra cost for processing two-ounce letters.

The Commission should delay no longer. It should begin to take the first step towards achieving its "ultimate goal" (as reiterated in Docket No. R94-1) "to set a degressive rate which reflects cost incurrence."

CONCLUSION

In previous rate cases, the Commission has deferred reductions in First-Class Mail's excessive burden because of concern about the impact upon other mail classes and subclasses. In this relatively small rate proceeding, however, no type of mail is threatened with rate shock. Combined with the Postal Service's current prosperity, this provides the Commission with an unprecedented opportunity to take another step towards fairer First-Class rates. *If not now, when?*

Respectfully submitted,

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April 1, 1998

ATTACHMENT A

MAJOR ERRORS IN THE BRADLEY ANALYSIS OF MAIL PROCESSING LABOR COSTS

The Commission has traditionally regarded mail processing labor costs as 100 percent variable with mail volume. Seeking to belittle the Commission's precedents, the Service characterizes the 100-percent-variable rule as a "simplistic and inaccurate assumption..." (USPS Trial Br., p. 21). The Service's witness Bradley purports to show that mail processing labor costs are not fully variable (USPS-T14).

In fact, as UPS' econometrician (Dr. Neels) and an OCA economist (Dr. Smith) testified, it is witness Bradley's presentation that is flawed.

The major conceptual error in the Bradley study is that it is neither a true measure of cost nor a true measure of volume. (See Neels, Tr. 28:15594; see also Smith, Tr. 28:15825-26). First, Dr. Bradley's econometric equations look not at cost, but at labor hours (Neels, Tr. 28:15589). But hours are not a suitable proxy for costs (Neels, Tr. 28:15594-97). Secondly, Dr. Bradley's econometric equations look not at volumes, but rather at piece handlings (Neels, Tr. 28:15590). But piece handlings are not a suitable proxy for volume (Neels, Tr. 28:15598-600).

Dr. Bradley's data is also suspect. Although Dr. Bradley relies heavily upn MODS piece handlings data, the Postal Service's own Inspection Service has questioned that data's accuracy (Neels, Tr. 28:15601). Additionally, in "scrubbing" the data, Dr. Bradley discarded enormous amounts of data without adequate justification.

(See Neels, Tr. 28:15609-16; see also Smith, Tr. 28:15853.) Had Dr. Bradley used the "scrubbed data, those data would have drastically changed his study's results. (Neels, Tr.28:15616-19).

Lastly, the Bradley study used models which, because they are premised upon only a single accounting period , can provide only a short-run view of labor cost variability. (See Neels, Tr.28:15591,15625-26); Smith, Tr. 28:15823, 15835-38.)

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document, by First-Class Mail, upon the participants in this proceeding.

April 1, 1998

Jeffrey Plummer